FILE COPY

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1937

No. 772

LIBERTY-STRATHMORE IRRIGATION DISTRICT,

Appellant,

v.

MILO W. BEKINS and PAUL J. BEKINS, as Trustees appointed by the Will of Martin Bekins, Deceased,

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF OF AMICUS CURIAE STATE OF

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LINDSAY-STRATHMORE IRRIGATION DISTRICT,

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MILO W. BEKINS and FRED J. BEKINS, as Trustees Appointed by the Will of Martin Bekins, Deceased, *et al.*,

Appellees.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA

BRIEF OF AMICI CURIAE FOR THE STATE OF WASHINGTON

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STATEMENT

The Legislature of the State of Washington has a law creating and maintaining the State Department of Conservation and Development. The Director of that Department, among other things, is charged with the authority and duty of rendering engineering and financial assistance to districts organized for the reclamation and develop-

ment of agricultural lands in the state. The Director is authorized to loan money to these districts and to accept the bonds thereof as evidence of such loans. (Rem. Rev. St. of Washington, Sec. 3004 *et seq.*) Several million dollars have been loaned to districts in this connection. The Attorney General of the state is by law the legal advisor of this Department. (Rem. Rev. St. of Washington, Secs. 112; 11032.) These local reclamation districts are included within the scope of the Local Taxing Agency Bankruptcy Composition Act of August 16, 1937 (11 U. S. C. A. Chap. 10, p. 1222) under examination in this case. The State of Washington and its officers, therefore, are vitally interested in the issues involved in the above entitled cause and the undersigned appreciate the opportunity of making the following observations as *Amici Curiae* for such consideration as these observations may seem to suggest.

ARGUMENT

1. Issues Limited to Constitutionality of Act Under Tenth Amendment

The appeals in this cause, as we understand, have been taken here under the provisions of the Act of August 4 1937 (28 U. S. C. A. Sec. 349a, p. 40) and the only issue involved is that of the constitutionality of the Local Taxing Agency Bankruptcy Composition Act of August 16, 1937 (11 U. S. C. A. Chap. 10, p. 1222). The issue of constitutionality, it appears, is also limited to the one inquiry whether the Act in question authorizes unreasonable impairment of state sovereignty in violation of the Tenth Amendment of the Constitution of the United States.

2. Governmental Character of Taxing Agencies Coming Within Act Not in Dispute

The scope of the Act in question is limited to certain classes of local taxing agencies designated therein. The Act deals with the composition of indebtedness of these local taxing agencies under the bankruptcy powers of Congress conferred by Section 8, Article 1 of the Federal Constitution.

In the case of *Ashton v. Cameron County Water Improvement Dist. No. 1,* (1936) 56 Sup. Ct. 892, 298 U. S. 513, 80 L. Ed. 1309, this court held that the Municipal Debt Readjustment Act of May 24, 1936 (11 U. S. C. A. Chap. 9, p. 1212) was unconstitutional. The unconstitutional Act was somewhat broader in scope, dealt with municipalities and other political subdivisions of the state but included most if not all the classes of taxing districts enumerated in the new Act. In the unconstitutional Act these local taxing units are referred to as political subdivisions of the state and in the last Act they are referred

to as taxing agencies or instrumentalities. Both Acts, however, refer in the main to the same identical agencies so far as these agencies are included in the last Act.

These references to classes of local taxing agencies, in our view, are made for purposes of identification only and are not made with any legislative intent to define the nature and legal status of these agencies. Manifestly, these agencies are creatures of the state, subject to change at any time by state law.

The nature and legal status of these local agencies have been built up through years of state judicial and legislative experience. Property values and taxing policies have been and are being established upon generally accepted concepts regarding these agencies which are all matters of exclusive state control.

The nature and legal status of these taxing agencies are not, therefore, changed by the new law merely by a change in nomenclature. With the exception of counties and parishes omitted in the new Act, both Acts deal substantially with the same identical classes of agencies. The manifest intent of both Acts is to deal with certain designated local taxing units, which are the same in both Acts, regardless of the identifying name by which they are designated.

The character of these taxing agencies then does not appear to be in dispute here. They are agencies of the state and they perform certain governmental functions.

New Orleans v. Morris (1881) 105 U. S. 600, 602, 26 L. Ed. 1184;

Shoemaker v. U. S. (1893) 147 U. S. 282, 297, 37 L. Ed. 170, 13 Sup. Ct. 361;

Fallbrook v. Bradley (1896) 164 U. S. 112, 174, 41 L. Ed. 369, 17 Sup. Ct. 56;

O'Neill v. Leamer (1915) 239 U. S. 244, 251, 60 L. Ed. 249, 36 Sup. Ct. 54;

Houck v. Little River District (1915) 239 U. S. 254, 261, 60 L. Ed. 266, 36 Sup. Ct. 58;

Roberts v. Richland Irr. District (1933) 289 U. S. 71, 77 L. Ed. 1038, 53 Sup. Ct. 519;

Brush v. Commissioner (1937) 300 U. S. 352, 366, 81 L. Ed. 691, 57 Sup. Ct. 495.

These local taxing districts are considered state agencies by the state courts in the following cases:

Morrison v. Smith Bros. (Cal. 1930) 293 Pac. 53;

Sutro Heights Land Co. v. Merced Irr. Dist. (Cal. 1931) 296 Pac. 1098;

Yale v. Modesta Irr. Dist. (Cal 1932) 13 Pac. (2d) 908;

Rathfon v. Fayette Oregon Slope Irr. Dist. (Ore. 1915) 149 Pac. 1044;

Twohy Bros. Co. v. Odioco Irr. Dist. (Ore. 1922) 210 Pac. 873, 216 Pac. 189;

Brown Bros. v. Columbia Irr. Dist. (Wash. 1914) 144 Pac. 74;

Shimada v. Diking Dist. of Skagit County (Wash. 1925) 245 Pac. 916;

Washington Nat. Inv. Co. v. Grandview Irr. Dist. (Wash. 1933) 28 Pac. (2d) 114;

Mola v. Metropolitan Park Dist. (Wash. 1935) 42 Pac. (2d) 177.

The question here is not whether these taxing agencies perform governmental functions—that may be assumed as true—but whether the Act in question authorizes an unconstitutional interference with the exercise of these functions.

3. Relation of Fifth Amendment to Act Settled by Previous Decisions

It has been suggested that the Act involved violates the Fifth Amendment of the Federal Constitution. It appears to us that this question has already been disposed of by the decision of this court involving the Interstate Railroad Reorganization Act (11 U. S. C. A. Sec. 205, p. 1017) in the case of *Continental Ill. Nat. Bank v. Chicago R. I. & P. Ry. Co.* (1935) 294 U. S. 648, 79 L. Ed. 1110, 55 Sup. Ct. 595.

Without attempting to go into the history of the law of bankruptcy in this country—a very instructive historical statement is found in the *Continental Bank* case *supra*—it may be stated that recently there have been extensions enacted in the bankruptcy law. The most notable examples are found in:

1. Agricultural Compositions and Extensions Acts (11 U. S. C. A. Sec. 203, p. 974);
2. Interstate Railroad Reorganization Acts (11 U. S. C. A. Sec. 205, p. 1017);
3. Corporate Reorganization Acts (11 U. S. C. A. Sec. 207, p. 1057).

The relation of each of these Acts to the Fifth Amendment of the Federal Constitution has been considered by this court in the following cases:

(Agricultural Compositions and Extensions Acts) *Wright v. Vinton Branch etc.* (1937) 300 U. S. 440, 81 L. Ed. 736, 57 Sup. Ct. 556;

(Interstate Railroad Reorganization Acts) *Continental Ill. Nat. Bk. v. Chicago R. I. & P. Ry Co.* (1935) 294 U. S. 648, 79 L. Ed. 1110, 55 Sup. Ct. 595;

(Corporate Reorganization Acts) *In re Wetherbee Court Corp.* (1937) 88 Fed. (2d) 251 certiorari denied 57 Sup. Ct. 931.

In each of these cases, the court held that this section (Fifth Amendment) of the Federal Constitution is not violated.

The Act in question in the instant case is no greater transgressor of this constitutional provision than the other recent bankruptcy acts. All bankruptcy acts may legally impair contracts indirectly and incidentally. *Continental Bank v. Rock Island Ry., supra.* This Act may possibly do the same, but such effect is constitutionally justified on the same grounds as in the case of the other recent acts approved by this court. These issues have been settled by the decisions above mentioned and present no constitutional problem in this case.

4. Act Meets Uniformity Requirements of Constitution

It will be conceded, we assume, that the Act meets the uniformity requirements of the Federal Constitution.

Hanover Nat. Bk. v. Moyes (1902) 186 U. S. 181, 46 L. Ed. 1113, 22 Sup. Ct. 857;

Stellwagen v. Clum (1917) 245 U. S. 605, 62 L. Ed. 507, 38 Sup. Ct. 215.

The only issue here then is whether the Act in question authorizes the impairment of state sovereignty in violation of the Tenth Amendment of the Constitution of the United States.

5. State Attitude Worthy of Consideration

The State of Washington passed legislation authorizing local taxing districts to accept the privileges of the

Act of May 24, 1934 (Rem. Rev. St. of Washington, Sec. 5608-1 *et seq.*). Similar legislation has been passed by some of the other states. *Ashton v. Cameron County Dist.* (1936) 298 U. S. 513, 539, 56 Sup. Ct. 892, 80 L. Ed. 1309. While state legislation cannot enlarge the power of Congress, it shows state policy in this connection. The implication of state sovereignty is that the state itself has some part in construing its sovereign powers and the attitude of the state in a given situation is a matter which the court may properly consider in determining whether a Federal statute impairs state sovereignty.

6. State Agencies Accept Benefits of the Federal Bankruptcy Laws in Certain Instances

In any event, state sovereignty does not constitute a quarantine against all participation by state agencies in the benefits of the Federal Bankruptcy Laws. Under their general authority to sue and be sued, these agencies are authorized to prove their claims against a bankrupt. They are also authorized to litigate their bankruptcy claim rights in the bankruptcy court. The same rule applies to states. *N. Y. v. Irving Trust Co.* (1933) 288 U. S. 329, 77 L. Ed. 815, 53 Sup. Ct. 389. Aside from the bankruptcy statutes, these local agencies are authorized to compromise claims. *Louisiana v. Jack* (1917) 244 U. S. 397, 61 L. Ed. 1222, 37 Sup. Ct. 605. They may also enter into arbitration agreements. *Alameda County Water District v. Spring Valley Water Co.* (Cal. 1924) 227 Pac. 953. Obviously the exercise of these privileges on the part of these agencies involving certain discretionary powers concerning their contracts and obligations, cannot be considered an impairment of state sovereignty; on the contrary, the exercise of these privileges is in the interest

of state sovereignty. It follows, therefore, that there are certain privileges which a state agency may at its option rightfully exercise under the bankruptcy laws. The problem here is to ascertain whether the Act in question offers privileges which the state agency cannot accept and fulfill without violating some constitutional provision.

7. Essential Features of Act in Question

The essential features of the Act with which we are here concerned are (11 U. S. C. A. Chap. 10, p. 1222):

1. That the debts are discharged upon the basis of appraisal of the debtor's assets with extension of time for payment rather than upon the basis of immediate and forced sale of assets and application of the proceeds therefrom to the debts so far as such proceeds will go, and the debtor is permitted to continue in business.

2. That a majority of the creditors, placed at so large a percentage of them as to amount substantially to a virtual representation thereof, is given authority to enter into voluntary agreements of composition, governing the entire indebtedness of the class of indebtedness involved, with a debtor, which debtor is not required in order to make an offer of composition to have been adjudged a bankrupt.

The provisions of the general bankruptcy law which might be construed when applied to state agencies to interfere with state sovereignty are eliminated from this Act. It does not in any material sense interfere with the debtor's exercise of its essential governmental functions. Its incidence, so far as any compulsion is concerned, is on the minority creditors and it is calculated to free the practical ability of the debtor to exercise its governmental functions. It is essentially a composition statute. Com-

positions under the Act are voluntary agreements between the debtor and the creditor. The compulsion of the minority is an incident and not the compelling basis of the settlement. It is a compulsion not exclusively for the benefit of the debtor but for the benefit of the majority of the creditors as well. It is the exercise of a power required for the protection of the majority creditors and does not involve the sovereign rights of the state except in a most negligible manner.

8. Court's Function Is Limited

The Act does not authorize the Federal Courts to exercise control over any essential governmental function of the debtor agency. The agency control has already been exercised by the debtor agency itself by its decision to file the petition and by its offer of composition. The court is not authorized to determine the terms of the composition. This determination has been made by the debtor agency in its offer. The court's function is limited principally to the ascertainment of the sufficiency of the petition and its compliance with the provisions of the Act, and of the good faith of the parties, to the enforcement of the procedural requirements of the Act and to the enforcement of the agreement of composition already made between the debtor and the required number of its creditors. The apparent interference with state sovereignty involved in the incidental compulsion of the minority creditors in reality enhances state sovereignty in that it makes the practical exercise of state sovereignty possible in the premises.

The acceptance of the privilege made available by the new Act is optional in any instance with the debtor agency. While this optional feature does not confer any additional power upon the debtor, it does limit the power

of the bankruptcy court and it is one of the features which, in our view, brings the Act within constitutional requirements.

9. First Act Broader in Scope

The first Act (11 U. S. C. A. Sec. 303 *et seq.*) was broader in its scope than the Act involved here. This is especially true by implication and it is also true by specific provision. The first Act gave the court authority over the readjustment of the obligations of the debtor, independent of the consent of the district or of its creditors. For example ,the court was authorized, with the approval of the taxing district, to direct the rejection of its contracts executory in whole or in part, without the consent of the other party of the contract. (11 U. S. C. Sec. 303 sub-sec. (c) (5), p. 1215.) No such authority is provided in the new Act. While the first Act denied to the court the authority to interfere with any of the political or governmental powers of the taxing district, it did extend to the court the power to determine what property or revenues of the taxing district were necessary for essential governmental purposes. (11 U. S. C. A. Sec. 303 sub-sec. (c) (11) (c), p. 1216.) In the new Act the power of judicial opinion in this respect is eliminated and the exemption of the district property and revenues necessary for essential governmental purpoess is guaranteed to the debtor as an absolute right. (11 U. S. C. A. Sec. 403 sub-sec. (c) (b), p. 1226.) The first Act related to the readjustment of the obligations of the debtor and carried with it an implication of power on the part of the court to pass upon the terms of the debt settlement and the means by which the settlement was to be effected without due regard to the exclusive right of the taxing district to continue the exercise of its gov-

ernmental functions without outside interference. The powers over debtor districts conferred by the Act upon the court was thought to interfere with the governmental functions of these districts and was banned by this court in the case of *Ashton v. Cameron County Dist.* (1936) 298 U. S. 513, 80 L. Ed. 1309, 56 Sup. Ct. 892.

10. Congressional Endeavor to Correct Constitutional Ojections

In an endeavor to correct the constitutional objections of the first Act, Congress, after full consideration, passed the Act involved in the instant case. The objects of the New Act within its restricted scope are essentially the same as that of the original Act but the attempt to obviate any substantial interference with the governmental functions of the taxing agency debtors is apparent throughout the Act. Reenactments designed to meet objections called to attention by the judiciary are frequently favorably considered by the courts where such objections are substantially met.

Hill v. Wallace (1922) 259 U. S. 44, 66 L. Ed. 822, 42 Sup. Ct. 453;

Chicago Board of Trade v. Olson (1923) 262 U. S. 1, 67 L. Ed. 839, 43 Sup. Ct. 470;

Liability Cases (1907) 207 U. S. 463, 52 L. Ed. 297, 28 Sup. Ct. 141;

Second Employers' Liability Cases (1912) 223 U. S. 1, 56 L. Ed. 327, 32 Sup. Ct. 169;

Wright v. Vinton Branch (1937) 300 U. S. 440, 81 L. Ed. 736, 57 Sup. Ct. 556.

The Act in question enlarges the scope of the bankruptcy law as applied to local governmental agencies but it carries no innovation in principle from that involved in

extension statutes above mentioned, including the icultural Relief, Interstate Railroad, and Corporate rganization, Acts. Different features appear in these s to adapt them to the necessities of the situation to ch they are applicable. The underlying basis of these s is the same, namely, to permit a continuation of the tions of the debtor, by a re-examination of indebted- based upon appraisals rather than sale, upon debt ex- ions, and upon compositions voluntarily entered into veen the debtor and a substantial majority of the litors.

The local taxing agencies covered by the Act in ques- exercise business functions in furtherance of the gov- nental objects of their creation. The Act in question s not extend its powers outside these business func- s. It extends privileges which the debtor and the litors, at their option, may accept for their manifest ual benefit. In the matter of tax exemption, this t has established a line between immediate govern- tal functions and remote governmental functions and approved denial of tax exemption where the tax, al- gh related somewhat to governmental activity, lays lirect burden upon a governmental instrumentality constitutes only remote, if any, influence upon the cise of the functions of government.

Helvering v. Mountain Producers Corp., No. 600 r. 7, 1938) — Sup. Ct. —, and cases therein cited.

A similar principle of distinction between Federal lation which interferes directly with state govern- tal functions and that which relates only remotely nconsequently to such functions might be recognized

in the instant case. The law in question does not impair the authority of the debtor taxing agencies fully to exercise their respective governmental functions, and in our view, does not constitutionally impair state sovereignty.

11. State Sovereign Rights in Their Relation to Federal Powers

The sovereign rights of the states under our constitutional system must be considered in their relation to the powers of the Fderal govrnment. It is not reasonable that the surrender by the states of part of their sovereignty to the central government through the Constitution of the United States should be construed to prevent the practical exrcise of their reserved sovereign rights.

The states have surrendered plenary and paramount authority over bankruptcy to the central government by Clause 4, Section 8 of Article 1 of the Federal Constitution.

Campbell v. Alleghany Corp. (1935) 75 Fed. (2d) 947 certiorari denied 296 U. S. 581, 80 L. Ed. 411, 56 Sup. Ct. 92;

N. Y. v. Irving Trust Co. (1933) 288 U. S. 329, 77 L. Ed. 815, 53 Sup. Ct. 389.

When a local taxing agency of a state becomes insolvent it falls short of carrying out its governmental functions. These functions involve the exercise of the reservd rights of state sovereignty. Having surrendered all bankruptcy powers, the state becomes powerless in this situation, and its sovereignty in this particular must atrophy unless the central government has authority to offer an opportunity for relief.

12. CONCLUSION

The Act in question is designed to meet a peculiar constitutional situation arising out of our dual system of Federal and state sovereignties. The Act allows a continuation of the governmental functions of the local taxing agencies without exerting any substantial control over them and affords a practical means of protection for their creditors. The acceptance of the privileges of this Act on the part of these taxing agencies therefore cannot reasonably be construed as an impairment of state sovereignty, and the Act should be sustained.

Respectfully submitted,

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